


**2024  
National Income Tax  
Workbook**

Chapter 2 : Trusts and Estates  
PP 49-78




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<b>Chapter Topics</b>	<b>P. 49</b>
➤ <b>Topic 1: Cancellation of Estate Debt</b>	<b>51</b>
➤ <b>Topic 2: Partial Interest Gifts</b>	<b>55</b>
➤ <b>Topic 3: Planning for Use of the Increased Exclusion amount</b>	<b>61</b>
➤ <b>Topic 4: Grantor Trusts</b>	<b>67</b>
➤ <b>Topic 5: Jointly Owned Property</b>	<b>71</b>
➤ <b>Topic 6: Life Insurance Proceeds Used for a Redemption</b>	<b>75</b>

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**Topic #1  
Cancellation  
of Estate  
Debt  
P51**

**What is Cancellation of Debt (COD)?**

The difference between the outstanding balance owed on debt and the amount accepted in satisfaction of this balance.

In general, COD is taxable under §61 unless:

1. It is a gift
2. It is a deductible debt
3. It is a purchase price reduction

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Cancellation of Estate Debt P.51

- Local law determines the time and manner for filing a claim against an estate
- If not done timely, and the claim is barred, the estate may have COD income

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Cancellation of Estate Debt P.51

Insolvency Exclusion under IRC §108(a)(1)(B):

- COD is taxable only to the extent the estate is solvent
- Insolvency is defined as excess of liabilities over the fair market value of assets
- Grantor trust and Disregarded entities the solvency test is applied to the deemed owner

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Example 2.1 P.52

Assets		Liabilities	
Home	300,000	Mortgage	260,000
Cash	5,000	Credit Cards	55,000
		Unpaid Hospital Bills	15,000
Total	305,000	Total	330,000

Because liabilities exceed assets by \$25,000, the COD of \$20,000 is not taxable

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**Gross Estate Inclusion** **P.52**

- IRC §2033 – Gross estate includes the value of all property to the extent of the decedent’s interest at the time of his or her death
  
- Notes or debts held may be included even if they are cancelled by the decedent’s will, depending on whether the terms indicate a bona fide sale

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**Debts Owed to Decedents-  
Installment Obligations** **PP52-53**

- Estate of Moss v. Commissioner, 74 T.C. 1239 (1980) Notes were not included in gross estate because cancellation provision was part of the bargained consideration
  
- Estate of Buckwater, 46 T.C. 805 (1966) Loan between father and son with no consideration. Unpaid principal was includible in the gross estate under IRC §2033

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**Factors Considered to determine  
there is no legitimate loan:** **P.53**

1. Lack of adequate consideration
2. Cancellation not bargained for
3. Unsecured note
4. No fixed repayment schedule
5. No payments made
6. Decedent has power to determine if note will be forgiven
7. No expectation of repayment
8. No intent to enforce collection

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**Income in Respect to the Decedent P.53**

If an installment obligation is transferred to an estate,  
Face amount less decedent's basis = IRD

If obligation is cancelled at death, right to the IRD transfers to the  
borrower and deceased seller's estate recognizes the unreported  
gain

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**Rev Rul 86-72 P.53**

- Individual sold property on installment sale
  - Cash down, annual installments over 4 years + 11% interest
- Sales agreement states that all amounts due are cancelled on seller's death
- Seller dies 2 years after the sale
- Gain on the outstanding payments is included in the gross income of the seller's estate

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**Practitioner's Note P.54**

- IRC § 691 was enacted so that the purchaser receives full cost basis because the seller recognizes the gain on the sale
- If an estate cancels a personal loan, it is a gift or bequest and does not constitute IRD nor COD income to the borrower

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**Topic #2**  
**Partial Interest Gifts**  
**P.55**

IRC §170(f)(3) denies a deduction for partial interest gifts

There are exceptions:

- Partial interest if it is the donor's entire interest in the property
- Life estate in personal residence or a farm
- Estate contribution to both charitable and noncharitable donee

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**Example 2.2** **P.55**



Aaron donated the use of the top floor of his office building rent free to a non-profit

Partial interest – no deduction

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<p><b>Example 2.3</b></p> <ul style="list-style-type: none"> <li>• Marylou gifted securities to Andrew</li> <li>• Marylou gifted remainder interest to Beau</li> <li>• Beau donated them to a 501(c)(3)</li> <li>• Beau can take a deduction for the present value of the remainder interest</li> </ul>	<p style="text-align: right;"><b>P.55-56</b></p> <p><b>Example 2.4</b></p> <ul style="list-style-type: none"> <li>• Marylou transferred the remainder interest to Beau</li> <li>• Marylou contributed the income interest to charity</li> <li>• No deduction allowed for Marylou of the income interest</li> </ul>
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<p><b>Undivided portion of Entire Interest P.56</b></p> <p>IRC §170(f)(3)(B)(11) Allows a deduction for a contribution of a partial interest if it is the donor's entire interest in the property</p> <p>An undivided portion of a donor's entire interest consists of:</p> <ol style="list-style-type: none"> <li>1. A fraction or % of each interest or right</li> <li>2. Must extend over the entire term of the property</li> <li>3. Cannot be divided to create such interest</li> </ol>
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<p><b>Examples 2.5, 2.6 and 2.7 P.56</b></p> <p><b>Example 2.5</b> Brendon White received a life estate in a building from his business partner. He can claim a deduction for his 1/2 interest.</p> <p><b>Example 2.6</b> Naomi's father established a trust which pays income and principal to Naomi's mother. Upon the mother's death Naomi receives the remainder and donates that 20% to charity. She can take a deduction for it.</p> <p><b>Example 2.7</b> Barbara Dean contributed an undivided 1/2 interest in 100 acres of land to charity. She is allowed a deduction.</p>
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**Retention of Substantial Rights** P.57

If the donor retains substantial rights when donating an item in perpetuity, a contribution deduction is not allowed. Ex. Donation of historic motion picture films where donor retains rights to make reproductions.

**Example 2.8** Jerry Jones donates a license to use a patent but retains the right to license it to others. No deduction.

**Example 2.9** Nikki Preston donated some of her stock but retained the right to vote on the contributed shares. No deduction.

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**Estate Tax Deduction** P.57

Deduction is disallowed for the same property given to both charitable and private donees when there is not adequate consideration except when it is the undivided interest of the decedent's entire interest.

**Example 2.10** Same facts as 2.5 except Brendan gave 1/2 to a charity and 1/2 to a business associate. Brendan's estate can claim a deduction because the life estate is his entire interest.

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**Contribution of Remainder interest in a Personal Residence** P.58

- IRC §170 allows for a deduction of a remainder interest in a personal residence. Even though this would not be considered to be the taxpayer's entire interest, a deduction is allowed.
- Personal residence not necessarily primary residence. Can be a vacation home.
- **Example 2.11** Cheryl Jensen donated a remainder interest in her vacation home in Florida. She retains the right to use it. She can claim a contribution deduction for the value of the remainder interest.

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**Testamentary Contribution** **P.58**

IRC §2055 allows a deduction on estate tax for the contribution of a remainder interest.

**Example 2.12** Same facts as 2.11 but instead of a lifetime remainder interest, Cheryl's last will and testament devises a life estate in the residence to her daughter and a remainder interest to a charitable organization. The estate can take a deduction for the value of the remainder interest.

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**Conditional Contribution** **P.58**

- If transfer for charitable purposes is dependent on some act to be effective, no deduction allowed
- If there is a condition of a required sale, there is no deduction
- Rev Rul 77-169 states that to be deductible the remainder interest must be in the residence itself and not the proceeds derived from the sale.

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**Estate of Blackford** **P.59**

- Different result than Rev Rul 77-169
- Wife died and left life estate to husband. Upon husband's death, the property to be sold and distributed to 4 charities.
- The estate tax return for the wife deducted the present value of the remainder interests passing to the charities.
- Court decided husband had no power to turn the residence into cash.

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**Contribution of Remainder Interest in a Farm P.59**

- Deduction is allowed for the irrevocable remainder interest in a farm
- Farm means land used by the decedent for the production of crops, fruit, or other ag. Products for the sustenance of livestock
- Livestock includes cattle, hogs, horses, mules, donkeys...
- An estate tax deduction is also allowed for the remainder interest in a farm.



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**Example 2.13 P.60**

Farmer Brown devised his 75 acre farm to his wife in a 10 year life estate and the remainder interest to a charitable organization.

His estate can take a deduction for the value of the remainder interest.



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**Topic #3 Planning for the Increased Exclusion Amount P. 61**

	2024	2026
Individual	13,610,000	5,000,000
Married Filing Joint	27,220,000	10,000,000

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**Gifts** **P.61**

- Estates compute tax using the higher of the basic exclusion amount applicable to gifts made during the life or the basic exclusion amount applicable on the date of death
- To avoid higher estate tax, taxpayers may want to consider making gifts before the exclusion amount reverts to former levels

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**Examples 2.14 & 2.15** **P.62**

Amy Dies in 2026		Amy gifts 2 x 5,000,000 in 2024	
Gross Estate	\$15,000,000	Gross Estate	\$15,000,000
Exclusion	7,000,000	Exclusion	10,000,000
Taxable	8,000,000	Taxable	5,000,000
Tax rate	40%	Tax rate	40%
Tax	3,200,000	Tax	2,000,000

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**Example 2.16** **P.63**

- Amir is single
- In 2024 Amir gave gifts of \$4,000,000 to his nieces and nephews when basic exclusion amount is \$13,610,000.
- Amir dies in 2028 when exclusion amount is \$7,400,000. His estate tax is based on the exclusion amount of \$7,400,000.

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**Gifts to Self** **P.63**

- Instead of gifting to children and losing control of the assets, taxpayers may gift to a trust for himself or herself
- Transfers made within 3 years of the date of death will be include in the estate
- A self-settled trust that is subject to creditors' claims is not a completed gift and is included in the estate and subject to estate tax

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**Gifts to Spouse** **P.64**

Irrevocable trust can be set up for spouse and make gifts before the exclusion amount decreases but if reciprocal trusts are done they may be treated as grantor trusts

Spousal Lifetime Access Trust (SLAT) – Established by one spouse for the benefit of the other

- ❖ Does not qualify for the gift tax marital deduction
- ❖ Uses donor spouse's basic exclusion
- ❖ Donor spouse must file gift tax return
- ❖ Can make distributions to the beneficiary spouse

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**Example 2.17** **P. 64**

<ul style="list-style-type: none"> <li>• Gross estate = 18,000,000</li> <li>• SLAT for Jan 9,000,000</li> <li>• Kim dies in 2029, no estate tax</li> <li>• Jan dies in 2031</li> <li>• 9M – 8M basic exclusion = 1M x 40%</li> <li>Estate tax = \$400,000</li> </ul>	<ul style="list-style-type: none"> <li>• No SLAT for Jan</li> <li>• Kim dies in 2029, no estate tax</li> <li>• Jan dies in 2031</li> <li>• 18M – 8M basic exclusion = 10M -7,600,000 (DSUE)x 40%</li> <li>• Estate tax = \$960,000</li> </ul>
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**Example 2.18**

- Reciprocal trust rules apply

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**Reciprocal Trusts** P.65

In *Levy*, the courts considered the following:

1. Were the trust created at the same time?
2. Do the trusts have identical trustees?
3. Do the trusts contain the same assets?
4. Were the trusts created pursuant to a prearranged plan?
5. Are the residual beneficiaries of the trusts the same?

Wife's power of appointment made trusts not reciprocal

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**Example 2.19** P.66

Jerry and Felicia both die in 2026:		If they had not made gifts:	
Gross Estate	25,000,000	Gross Estate	25,000,000
Less transfers:		Basic Exclusion	13,000,000
10,000,000			<hr/>
9,000,000	<u>19,000,000</u>	Taxable Estate	12,000,000
Taxable estate	6,000,000	Estate tax (40%)	4,800,000
Estate tax (40%)	2,400,000		

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**Topic #4**  
**P.67**  
**Grantor Trusts**

- A trust is a legal entity created by the grantor to manage and protect trust assets for the benefit of the beneficiary
- A grantor retains control of the assets and income
- In a grantor trust, the grantor is treated as the owner and trust is disregarded as a separate tax entity and all income is taxed to the grantor

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**Benefits of Grantor Trusts** **P.67**

1. No gift tax when assets are contributed to the trust -not considered to be a completed gift.
2. No separate tax return is filed. Income is included on the grantor's return
3. Trust assets don't go through probate.
4. Grantor retains control of the assets during their lifetime.

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**Attributes of a Grantor Trust** **PP 67-70**

1. Reversionary Interests §673
2. Power to Control Beneficial Enjoyment §674
3. Administrative Powers §675
4. Power to Revest Title to Grantor §676
5. Power to Use Income for the Benefit of the Grantor §677
6. Person Other than Grantor Treated as Owner §678

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**Topic #5**  
**Jointly**  
**Owned**  
**Property**  
**P.71**

An estate includes co-owned property unless the property originally belonged to survivor.

Three exceptions:

1. Spousal exception
2. Joint tenants with rights of survival
3. Qualified joint interest



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**Noncitizen Spouse** **P.71**

Practitioner's Note:

If surviving spouse is not a US Citizen, property's full value is included in the first decedent's estate

If the property held as tenants in common – 50% is included

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**Basis of Non-spousal Joint Tenants** **P.71**

- § 1014 – Property required to be included in the estate is included at FMV, thus receiving a stepped-up basis.
- § 2040 – A deceased joint tenant's estate includes the FMV of the decedent's proportional share, so the surviving tenant will receive a step-up in basis on the decedent's share of the property

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**Example 2.20** **P.72**



- Land purchased as joint tenants with right of survivorship
- Frieda didn't contribute to the purchase price
- Frank dies in 2024 –entire property is included in his estate
- Frieda gets a stepped-up basis on the entire property
- If tenants in common, only 1/2 is included in estate and stepped-up basis on 1/2

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**Example 2.21** **P.72**

- Ahmed and Cyril purchased land in North Dakota
- Ahmed contributed \$70,000 and Cyril \$30,000
- Ahmed died in 2024 –FMV \$200,000
- Ahmed's estate includes \$140,000 (200,000 x 70%)
- Cyril's basis is \$170,000 – his \$30,000 plus the \$140,000 from Ahmed



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**Depreciation Deductions** **P.73**

- When the surviving joint tenant becomes the sole owner of the property, they must reduce their basis by depreciation taken prior to death
- Reduced amount plus FMV basis of decedent's interest becomes the new basis

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**Example 2.22**

**P.73**

- Ahmad and Cyril purchase business equipment as joint tenants with rights of survivorship
- Ahmad contributed \$20,000 and Cyril \$10,000
- Under local law they are entitled to 50% of the property income
- Prior to Ahmad's death, they share the \$12,000 of depreciation
- At Ahmad's death, the FMV of the property is \$60,000

**Cyril's New Basis in the Property**

Cyril's initial contribution	\$10,000
Depreciation (\$12,000 ÷ 2)	(6,000)
Adjusted basis	<u>\$ 4,000</u>
FMV basis of Ahmad's interest (\$60,000 × ½)	40,000
Cyril's new basis in property	<u>\$44,000</u>

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**Basis of Spousal Joint Tenants**

**P.73**

**Noncommunity Property**

- The first spouse to die includes ½ value of the joint property gross estate
- The surviving spouse receives step-up in basis on the joint interest of the surviving spouse
- If spouses filed joint returns, surviving spouse must reduce basis by depreciation deductions
- If spouses filed separately, no reduction is necessary

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**Example 2.23**

**P.73**

Shonda	390,000	Shonda's new basis:	
William	<u>35,000</u>	425,000 ÷ 2 =	212,500
Total cost	425,000	William's share	<u>275,000</u>
		New basis in land	<u>487,500</u>
William dies FMV 550,000			
His gross estate 275,000			

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**Basis in Community Property** P.74

- Each spouse is treated as owning ½ the property
- If at least ½ of decedent's spouse's interest is included in the gross estate, the entire basis is stepped up to FMV
- No adjustment is made for depreciation deductions for surviving spouse

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**Example 2.24** P.74

Community property state

• Basis	80,000
• FMV	200,000
• Jerry's estate = ½ x 200,000	100,000
• Kerry's basis (full FMV)	200,000

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Topic #6  
P.75  
Life  
Insurance  
Proceeds

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**Proceeds paid to Estate or Beneficiary P. 75**

Life insurance paid to the estate or beneficiaries are included in the estate if the decedent had any incidents of ownership

1. Change the beneficiary
2. Surrender or cancel the policy
3. Assign the policy
4. Revoke the assignment
5. Pledge the policy for a loan
6. Obtain a loan against the surrender value

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**Irrevocable Life Insurance Trust P. 75**

To avoid life insurance proceeds from being included in the gross estate an irrevocable life insurance trust could be established.

Taxpayer can transfer cash to the trust and the trust can purchase the policy.

This is discussed in the 2022 National Income Tax Workbook.

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**Proceeds used for Redemption P.76**

- §2001 (a) Federal estate tax is assessed on the FMV of all property that passes from the decedent
- Life insurance policies are a factor to be considered
- Conflicting lower court decisions, and the issue was considered by the Supreme Court
- Eighth Circuit found they were included in the gross estate and Ninth and Eleventh found they were not

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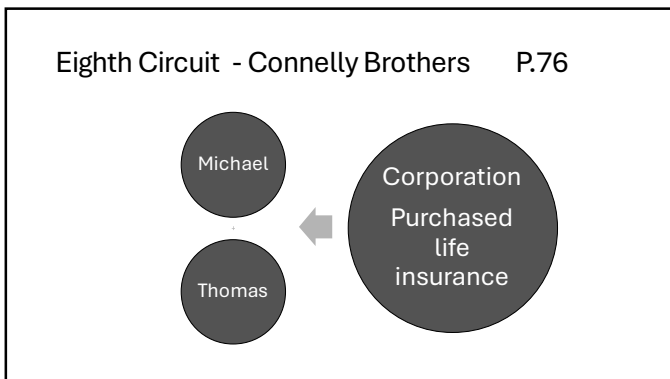
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Practitioner Note P.77

How to avoid the outcome in Connelly?

Cross-purchase agreement – Each shareholder purchases a life insurance policy on every other shareholder

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Questions?

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